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Banif Bank: value creation in the Maltese market

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Abstract: *The entry in a new market is always a major strategic challenge for a firm: competing in different regions and dealing with the specific conditions. This work project describes the entry of a new bank in the Maltese market, by exploring a new positioning. Through the real case of Banif Bank, this case intends to evaluate the potential of value creation in that industry, by first assessing its attractiveness and profitability. Then, Banif Bank positioning is analyzed to conclude if it can create a competitive advantage that would be sustainable in the long term.*

Keywords: Maltese banking industry, intensity of competition, strategic positioning, sustainable competitive advantage

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Introduction

To celebrate the twentieth anniversary, Banif Financial Group presented a whole new image reflecting the maturity and experience attained, permitting to better face future challenges in this new chapter of its corporate existence. This re-branding allows the institution to reinforce its brand awareness, crucial for the expansion strategy, to boost the home market organic growth but also to penetrate in new foreign countries, consolidating Banif brand. This turning point in the organisation complements a new strategic orientation for a strong international expansion, demonstrated by the last acquisitions both in Spain and Cape Verde, the continuous investment in the Brazilian operation, as well as the creation of a new bank in one of the last European Union members, Malta.

This Work Project intends to explore, throughout the development of a case-study, the entry of Banif in Malta. The objective of this work is to analyze the value creation potential of an entrant in this specific market, by choosing a new strategic positioning that will permit that firm to present a different value proposition, perceived by the market.

The approach to this problem was based on the experience of a strategic consulting firm, soarspartners, which provided external advising for the new positioning creation. This project has been developed after an internship, during which the author was integrated in the team that worked three months jointly with the bank administration, on site, to design a strategic approach for that market, aligned with the client expectations, company values and specific customers needs. During the

development of the case-study, several sources of information were used. Bank reports and other financial institutions databases were consulted, as well as all the knowledge acquired during the groundwork at Banif Bank Malta. However, one faced a profound lack of information, mainly due to the poor quality of the reports produced by banks, regulatory institutions like Bank of Malta and Malta Financial Services Authority, as well as Malta's Bankers Association.

The study is divided in two main parts: Case-Study and Teaching Note. The first part begins by presenting Malta's macroeconomic outlook. Then an overview of the country's banking industry is performed, addressing both demand and competition. After that, a description of Banif Financial Group is realized, addressing its size and growth. Finally, the value proposition for the new bank, Banif Bank Malta p.l.c, is presented. In the second part, always based on a literature review, we begin by analyzing the market attractiveness, looking at its dimension and the intensity of competition. Then, the proposed competitive positioning of the new bank is discussed. Finally, the potential that this positioning has to create a sustainable competitive advantage will be analyzed, looking at the strategic resources Banif is trying to develop.

Part I: Case study

Malta's macroeconomic outlook

Standing in the centre of the Mediterranean Sea, Malta's group of islands has a population of 400,000 inhabitants and an area of 316 km². One of the smallest and most densely populated EU member states, it joined European Union in May 2004 and the euro in January 2008, completing its full economic and monetary integration.

With a GDP of around €5.1 billion and a 3.8% growth rate in 2007¹, Malta has a rather open economy, dependent on manufacturing, especially electronics and pharmaceuticals, and a growing importance of tourism². Being a transitional economy in the EU context, the next years will provide the country with a set of opportunities for further upside in its performance, due to infrastructure development "powered by" EU funds (road and sea ports upgrade), support for SME restructuring in the new economic context, superior investment in human resources training programs, or the projected reforms in the Public sector and Social Security.

Hence, Malta will face in the near future a very important transitional period, which will surely be crucial regarding its economic development. Throughout this period, the existing traditional economic sectors will face increased challenges, in a context of more openness to competition from abroad, thus leading to the need for important reforms in the private and public sectors. Furthermore, national companies

¹ EU real GDP growth rate: 2.7%

² One company, ST Micro (electronic components manufacturer) accounts for 40% of the country exports.

will need to be very effective in using EU funds in order to adapt and increase their productivity levels.

In this context, the Financial Service sector has to play a key role, acting as an enabler and a support force for its clients, fostering a more entrepreneurial culture. It must provide sound advice on how to better explore existing opportunities and introduce products and services that increase their clients' competitiveness, convenience and value for money. In this way, the entry of a new player in the Maltese banking sector could lead to positive effects in the overall economy.

Malta's banking market

Demand overview

The Maltese can be considered a very religious and conservative people, being quite risk-averse and preferring long-term relationships, which can be explained by their loyalty but also by some convenience. They are also concerned with assets transmission through generations, investing mainly in property. Thus, these main characteristics can indicate some of the patterns of the Maltese banking market.

After 2001-2003 very low growth rates, the loan market shows a growing trend, mostly fuelled by the expansion in household loans - focus on mortgages, while consumer loans still stand for a limited share of the household loan portfolio. Part of the growth was driven by asset pricing increase, but nevertheless mortgage loans presented a quite sizeable growth. On the other hand, the corporate segment has been under a

downward trend since 2002, however it has been recovering in the last two years **(Exhibits 3&4)**.

Resident deposits have been growing at a rate of 7.4%, with corporate clients having a slightly higher increase. Nevertheless, households, with almost 80% of total amount, dominate the resident market, with a massive concentration of their savings in term deposits, with an €15000 average balance, and in other non-risky products **(Exhibit 5)**. Therefore, the Maltese banking sector shows a low transformation ratio of deposits into loans (around 75%), if compared with Portuguese banks, (around 150%), which signals excess liquidity from main banks and the availability of a solid funding base for business expansion in the loan side of the balance sheet.

Despite the recent mortgage growth, Malta still shows room for further increase in the loan business. Comparing outstanding household debt to disposable income across Europe, one can see that Malta started from a very low indebtedness in 1999 and even in 2002, and considering 2004 figures is still below 2002 figures for most of other European countries **(Exhibit 6)**. Given this, Malta presents a solid retail funding base, which can support a sustainable growth in loans, mostly in the household segment. Nevertheless, despite the corporate segment lower performance, SME's sub-segment may stand also as a key opportunity for growth, given their need to adapt and invest in new ways of doing business, combined with historical difficulties in this type of smaller companies in accessing loans by banks.

Competition

The Maltese banking sector has been growing at 10% over the last 10 years, presenting high profitability ratios, with a continuous decrease in the cost-to-income, below 50%, and a steady improve of the ROE, standing above 11%, reaching an impressive 30% for HSBC. These high figures for ROE are obtained despite the fact that most banks present comfortable capital adequacy levels, which reinforces the idea of attractive profitability. Price competition remains low, since all banks match each other, avoiding price wars and focusing on practising higher margins (Exhibit 7).

The declining cost-to-income ratios from top Maltese banks are based upon the ability to extract high income margins from the existing asset base, despite the fact that those banks carry a heavy cost base relative to the net assets under management, with cost-to-net assets close to 2% (Exhibit 8). The income generated by these banks benefits from high fee income and increasing financial margins, mostly due to the banks' ability to lower its funding costs while controlling loan margin erosion (Exhibit 9). In summary, Maltese banks seem to possess a very solid income base, at quite attractive margins, having been able to reduce their average deposit rates more than their average loans rate and therefore capturing a widening intermediation spread.

The Maltese banking industry is clearly dominated by two main banks, HSBC and BOV, together with almost 90% of market share in the residents loan business. Even considering the deposits market, the combined share of the two largest banks is still above 80% (**Exhibits 10&11**).

HSBC Malta

Part of HSBC Group, one of the major global banks, with business all over the world, HSBC Malta plc is the former Mid-Med Bank, a state-owned financial institution sold in 1999 to the British financial group. With around 1500 employees and 41 branches, it offers a wide range of financial products and services both to households and firms, leveraging the global presence of its parent.

HSBC leads credit granting in Malta, with €3.45 billion spread across both personal and commercial sectors, with other banks included. However, due to the already referred high local demand for savings products, the bank has enough customer deposits, around €4.1 billion, to face all lending requested without needing to raise capital from other banks, presenting a credit over deposits ratio of 82%, fact of great importance in the present liquidity crisis.

Analysing HSBC Malta performance, we can observe a 14% annual increase of its operating income from 2003 to 2007, mainly due to a solid net interest income growth (CAGR 03/07: 14%), being that the increase in interests receivable over-passed that of interests payable. These results are complemented by a good behaviour of trading profits and dividend income from subsidiary companies (CAGR 03/07: 22%), while the fees and commissions increased at a slower pace (CAGR 03/07: 7%). Additionally, operating costs have been growing slowly in the last years due to slight increases in administrative expenses and depreciation.

Finally the bank's equity slightly decreased to €232 million because of higher dividend distribution in the last years, while profits have been consistently growing,

reaching €71 million in 2007. So HSBC is the most profitable player in the Maltese banking industry, obtaining a ROE of 30% and a cost-to-income level of 42%.

BOV

Considered the people's bank in Malta, Bank of Valetta p.l.c (BOV) is the other major financial institution operating in the country. Created in 1974 by the Maltese Government to take over the assets and liabilities of the National Bank of Malta Ltd, as result of a run by its clients to withdraw all savings that lead the institution to close. Soon after the Government started selling stakes to other financial institutions like Banco di Sicilia and also to the general public until 1995, when the Government privatised BOV, reducing its shareholding from 51% to 25%. Nowadays the other major shareholder, beside the Maltese Government, is UniCredito Italiano S.p.A with 14.5%, taken over from Banco di Sicilia S.p.A in June 2006.

BOV has at its clients disposal a full range of financial services in personal, business and corporate banking, offered through 45 branches and 1400 employees. To compete with its most direct competitor, a global bank, BOV has been obligated to create an international network to better serve its clients, and also capture some of the Maltese emigrants communities, mainly in Australia and Canada. So the bank has been establishing a network of representative offices in those countries, and also in Italy, England, Tunisia and Libya because of strong relationship that Malta has with these partners, for historical or geographical reasons.

When speaking about customer deposits, BOV takes the lead with around €4.3 billion, that clearly allows the bank to face all its responsibilities regarding credit

granted by the institution both to private and business, including other banks, that stands around €3.1 billion. So BOV is in a rather comfortable situation in terms of capital financing, having a credit over deposits ratio of 61%.

Regarding its financial performance over the last years, we can observe a smoother growth than its direct competitor, with the operating income growing 8% annually in the 2003-2007 period. This resulted of an 12% yearly increase in the net interest income, due to a continuous growth of the loan book complemented by the improvement in its credit quality, but also by a restrained evolution of interests payable. Additionally a good behaviour of the fees and commissions income contributed to these results. However a clear slowdown in dividend income from subsidiary companies and trading profits didn't allowed BOV to have an even higher performance.

Finally, like its competitor, operating costs have been growing slowly in the last years due to slight increases in administrative expenses and depreciation. Therefore profits have been consistently growing, reaching €65 million in 2007. However a superior equity level comparing to HSBC, standing at €367 million, makes BOV less profitable, obtaining a ROE of 18% and a cost-to-income level of 42%.

Other competitors

Competing in a much smaller scale we can find a few other national and foreign players in the Maltese banking sector, like APS or Lombard Bank.

The first one belongs to the Catholic Church and was established in 1910 as a Savings Bank with the intent to inculcate savings habits amongst the working classes. The funds raised were used in various projects like a mutual benefit scheme, an evening

school and classes for craftsmen and also to help the poor, giving them free meals and medical care. With the formation of the Central Bank of Malta in 1967 and the subsequent banking sector legislation, a private limited liability company was created to take over the responsibility of running the Savings Bank. After a careful analysis of its potential, in 1990 an application was submitted to the Central Bank and a license issued in order to operate as a Commercial Bank, which allowed APS to offer a wider range of financial services. Nowadays it operates exclusively in Malta through 6 branches and 200 employees.

Due to its Catholic background, APS bank presents itself as a more conservative, low profile institution, with more restricted credit granting rules and an almost inexistent capital funding with other banks, financing its lending activities with customers deposits, resulting in a credit over deposits ratio below 60% ³. Nevertheless, the operating income has been growing at a good pace (CAGR 03/07:11%), thanks to both interest, fees and commissions income, combined with a slow increase in the operating costs. So profits have been improving over the last years, reaching €5 million in 2007, resulting in a 11% ROE and a 57% cost-to-income.

Lombard Bank Malta plc began operating in 1969, when Lombard North Central UK ⁴ activity in capturing deposits through local agents was formalised, giving birth to a wholly owned subsidiary of the British bank. Soon after the Maltese Government started acquiring shares of the bank, reaching a 60% stake in 1981, but totally divested

³ Amount owed to customers in 2007: €579 million; loans and advances to customers and other banks: €337 million

⁴ Member of the Natwest Bank Group

in 1990 when Lombard became a Public Limited Company and offered its equity to the market. Today the largest shareholder is Marfin Popular Bank Public Company of Cyprus, with around 43%.

This financial institution employs 150 persons, offering a full range of traditional commercial banking activities, with 6 branches spread throughout the country. However this network can be largely expanded because Lombard has a 60% stake in Maltapost plc, which has 50 agencies in Malta that can be used to also sell financial products. Even being a smaller player in the market, Lombard Bank has been performing well, with a continuous growth in the operating income (CAGR 03/07:13%) pushed mainly by the interest income, due to a decrease in interests paid mixed with a smooth growth of the interests received in the last five years. A tight control of the operating costs, that remained stable in the same period gives a further contribution to obtain a €6.7 million profit in 2007, a 13% ROE and an impressive 33% cost-to-income ratio, being the most cost-effective bank in Malta. Furthermore, the institution is making an efficient use of the costumers deposits ⁵ by granting credit, having a credit over deposits ratio of 82%, only comparable with HSBC in Malta.

Given this market structure, it seems that Malta faces a certain deficit of branch coverage comparing to other European markets, as Maltese bank branches tend to carry higher than European average deposits and loans. Although we should take into account that the indicator is certainly influenced by Malta's high population density levels, there

⁵ Amount owed to customers in 2007: €420 million; loans and advances to customers and other banks: €343 million

seems to exist market space for further growth in the retail network, which could take the form of a market entry by a new player (**Exhibit 12**).

Existing Maltese banks tend to rely heavily on a sizeable workforce, which hints for low labour productivity and legacy issues. In fact, the ratio of full-time equivalents (FTE) per branch in Malta is around 30, the double of the European average and almost three times higher than best practice markets such as Spain, for instance (**Exhibit 13**).

Furthermore, these financial institutions have been slow to adopt new processes, technologies and product & service innovations. For instance, home banking has been introduced in Malta only in the end of 2002, when this feature had become available several years before in other European markets. Another example, the focus on proprietary ATM networks instead of an “open access” option, have delayed the expansion of this kind of facility. The number of ATMs per cash function cards still remains low (1 ATM per 2600 cards vs. one ATM per 1200 cards in Portugal), hinting limited investment in the ATM network expansion.

Banif Financial Group

Banif SGPS, SA, the Parent holding company, is considered the seventh largest Portuguese financial group and holds a 4% market share in the national retail banking market. With an universal positioning, focused on a relationship banking, it operates in banking, insurance, leasing, consumer credit, factoring, renting, real estate, investment banking, asset management, international and off-shore banking.

The institution has been created in 1988 through the establishment of Banif - Banco Internacional do Funchal, SA, that took over all the assets and liabilities, including 10 billion PTE in accrued losses, to be depreciated over 3 years, of Caixa Económica do Funchal, a regional savings bank founded in Funchal back in 1879. Nowadays it employs nearly 3800 people and has 423 branches, including all group's businesses, serving around 1 million customers. With assets near €10.8 billions and €8.8 billion of credit granted, the group reached in 2007 a €101 million net profit and a 19,3% ROE, while pursuing a cost-efficiency strategy, reducing its cost-to-income to 57,5%.

Banif started by developing during the first years its business in the island of Madeira, having just a discrete presence in the mainland, pursuing a careful growth strategy. In 1996 Banif began building its presence also in the Azores island by leading the winning group bidding for the privatisation of 56% of Banco Comercial dos Açores, SA share capital, taking up a controlling position in this bank. Subsequently it took over Companhia de Seguros Açoreana, SA, a regional insurance company, that permitted Banif to diversify its activities into a sector essential to increase cross-selling levels inside the group.

With these acquisitions Banif reinforced its position as the leading Portuguese bank in the islands after 10 years of operations, and pursued constructing a larger presence in the mainland. The financial group also continued its expansion by consolidating its positions in the different businesses, with the increase in shareholding and further acquisitions, both in banking and insurance areas.

International expansion

Despite the fact that during these first 10 years of activity the financial group had been focused on national growth, the international business had already started with the opening of representative offices near the largest Portuguese emigrants communities, mainly from Azores and Madeira. These representations were installed in South Africa, Venezuela, Brazil, United States of America, Canada and United Kingdom to better serve these populations. At the same time Banif also created some off-shore banks in Cayman Islands and Bermudas for international operations.

However in 1999 the institution took a step further in its internationalisation and business expansion strategy with the acquisition of Banco Primus SA, a Brazilian investment bank and also a brokerage firm based in Rio de Janeiro with offices in São Paulo. Three years later the bank kept reinforcing its presence in this emerging market by acquiring another Brazilian brokerage firm, Indusval. From this moment on the internationalisation strategy started being modified, with the development of a new bank abroad. In order to offer a complete range of services in the most efficient way the institution restructured in 2004 the Brazilian operation, creating a commercial bank, Banif (Brazil) SA, and an investment bank, Banif Primus SA.

So the new international expansion strategy based on the creation of full operational banks abroad continued in the following years with multiple investments in Spain, acquiring a 33.3% share in Banco Pueyo and 27.5% in Bankprime, moving to a natural market for Portuguese internationalisation, but also expanding to Africa with the buy of Banco Caboverdiano de Negócios in Cape Verde (46% shareholding). The financial group chose to build an international presence mainly by acquiring fully

operational businesses, that permitted to gain instant market share - “buying share”- and cash-flow generation, but made it harder to create an unifying organisational system, designed by Banif, that could transmit the same values to all its clients and employees.

Banif Bank Malta plc

An opportunity was detected by Banif administration to develop a new bank in a fast growing EU market, dominated by two main players but still years behind the most modern banking industry existing in European markets in terms of sophistication of activities. The similarity between Malta and Madeira, “an island with approximately the same population, with an economy that highly depends of tourism”, as Banif Chairman Horácio Roque said, was one of the reasons that lead it to invest in this country. However, the promised large EU investments and its strategic geo-positioning as a bridge to North Africa were important points to consider this option.

The financial group chose to launch a full-scale banking operation, comprising retail and investment banking, on a joint partnership with four local investors, in an initial investment of €25 million, 72% belonging to the Portuguese institution. The main objective was to open up to 25 branches and capture 10% market share in a five years period, to clearly position itself as the third Maltese bank. Banif was aiming to be the alternative to the incumbents, being perceived not as a foreign but as an international bank, with strong Maltese shareholders and investors.

To better achieve this goal, a strong value proposition with an innovative positioning in the banking sector was crucial. For that reason Banif administration decided to contract the services of a strategy consulting company, soarspartners, in

order to develop a sustainable competitive market strategy. As a result of this project, the consultants advised the board to follow an entry strategy whose objective was to create an easy and aspirational bank, based on five main pillars:

Middle Market: Focus on Affluent and SME ⁶ segments on a first stage. According to a market survey carried out by the consulting company, they are more aware of Banif brand, more willing to open an account in a new bank, and looking for innovative products and solutions. They can also endorse Banif on a second stage, when penetrating the mass-market, creating them a desire to be part of a community.

Entrepreneurship: Target active wealth creators, both individual and business, presenting Banif as the bank for new ventures, specialized in financing new projects. Since the Maltese usually have a business of their own, besides their first job, the bank can act as an enabler, encouraging people to develop these businesses, by having specific financing products for entrepreneurs.

Hassle free: Offer competitive target-specific package solutions, simple products easy to understand, with transparent pricing, stripped out of unnecessary add-ons. A fast response is also crucial, having a pre-done risk assessment for instant approvals. Play as a broker and distributor of third part products (insurance, funds...).

Banif Mobile: To fight natural inertia and attrition, as well as the convenience that characterise the Maltese population, Banif has to take the bank to the clients, skimming the market top-down, sector by sector with push strategies, to accelerate penetration rate. For this a mobile sales force composed by Executive Consultants needs to be created to hunt for new target clients, conquering them prior to branch overture.

⁶ Small and Medium-sized Enterprise

Training sector specialists that are able to visit SME's and entrepreneurs, presenting them tailor-made solutions, is the objective. For this, each sector is carefully analyzed through profound research, focus groups, and professional chambers collaboration. The Executive Consultant is supported by a team of experts in asset management and financial markets, to ensure first class banking solutions. To complement the mobile team, a network composed of look&feel branches, with a modern layout designed to provide superior service and comfort for an exigent segment, as already done in several other European markets. As stated by Banif Bank CEO, Joaquim Silva Pinto "the Maltese branches are similar to the Portuguese Bank in the eighties". The deployment of this network results from a careful analysis of the market study conclusions, with each location being decided according to the mapping of the affluents presence in the territory.

Aspirational Brand: Build an aspirational bank with mass-exclusivity marketing approach and co-promotion. Support from key local players in this small community is essential to market penetration, both leading corporate owners that can endorse Banif brand to company staff, and affluent opinion makers from different professional classes spreading the bank image to their counterparts. The financial institution needs to create emotional ties through organisation of spontaneous events and links to communities of interest with idea enablers (inspiring ideas, personal goals, dreams and projects). Invest in public relations and formation of communities, instead of massive advertising spending. Organise exclusive events, inspiring industry venues and professional round tables with target segments, by inviting international experts, top professionals and companies, academic insiders or key suppliers and partners. An annual event that would

elect the best Maltese businesses, co-promoted with local players would enhance Banif image in the business sector.

This positioning was designed to overcome Maltese market challenges, responding to consumer value drivers like convenience, loyalty, risk-aversion or conservativeness.

To implement the value proposition Banif needed to create a very flexible and “light” value chain, to minimize costs while following the right positioning. Given this, the financial institution had to adopt a flexible and incremental cost structure, with minimum cost within approved image boundaries. For instance during early morning peak hours at the branch, some of the mobile sales force should reinforce branch staff, before starting to visit their clients, to face higher demand in an efficient way. A modular and scalable approach to key investments like infrastructure, systems and operations, could permit to reduce the upfront investment. All possible synergies with Banif Financial Group should be profoundly explored, leveraging scale economies in diverse fields, like manufacturing units, risk management expertise, marketing tools, training, manuals, and other core banking skills.

Additionally, in order to have a lean-banking, Banif should create simple processes, eliminating all non-adding value steps, with a quick response facilitated by an early client profiling and risk assessment in order to pre-approve credit. A strong investment in a modern and technologically advanced ATM network that would permit the bank to offer a multitude of new services in this channel, as well as a fierce incentive from the Executive Consultants to their clients for internet banking and call-

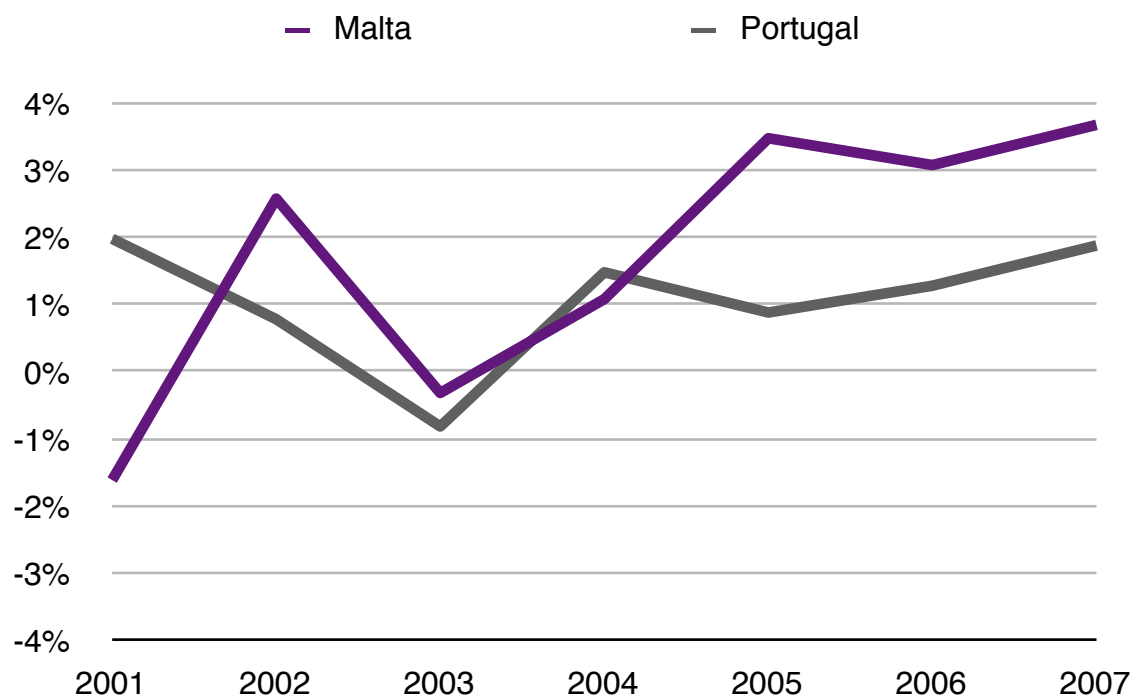
centre usage, would contribute to a high reduction of branch usage, minimizing costs. Finally a risk-sharing mentality should be embedded in all stakeholders: shareholders (starting with a growth strategy before moving to a return strategy), clients (Banif Counsellors⁷, Founders, Pioneers), providers (agents, it providers, etc.) and staff (incentive systems).

Although a new positioning, that could create new space in the market, was being proposed, wasn't this aim to become the third Maltese financial institution and capture a significant market share a very optimistic goal regarding specific market conditions and competition?

⁷ Leaders and opinion-makers within most prestigious professions in Malta who will sponsor Banif brand to their colleagues, and leading companies who will endorse Banif to their staff

Appendices

Exhibit 1: GDP growth for Malta and Portugal



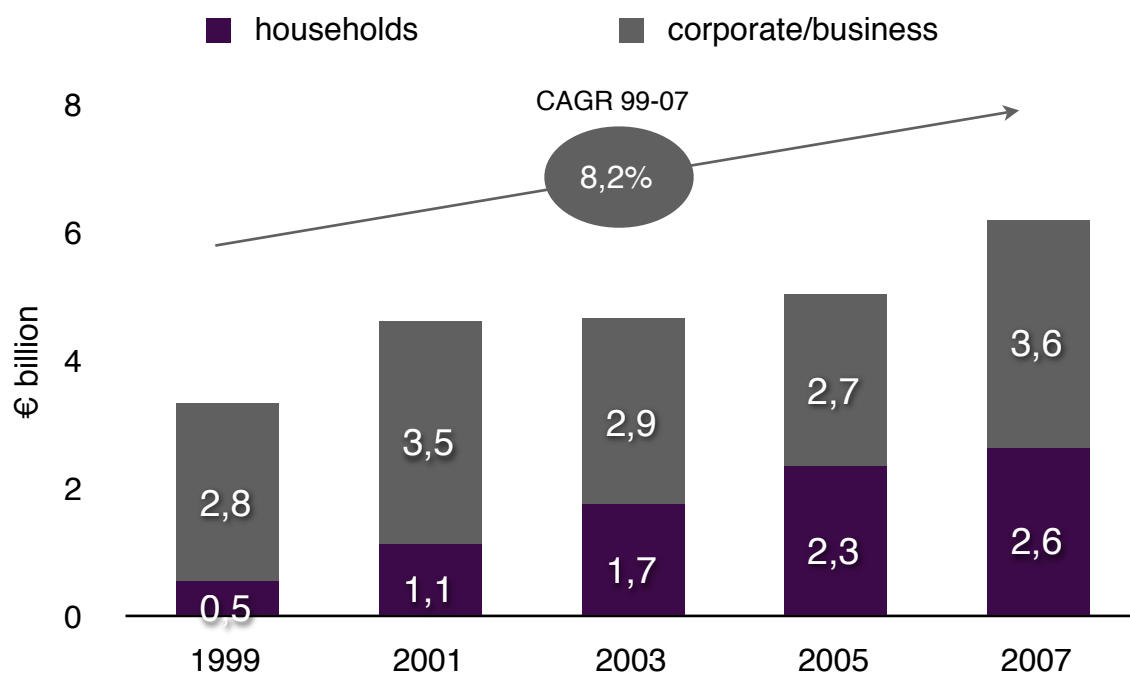
Source: Eurostat

Exhibit 2: Macroeconomic indicators for Malta

	2000	2002	2004	2006	2007
GDP per capita (€ thousand)	10,3	10,8	11,2	12,5	13,1
Inflation (%)	3	2,6	2,7	2,6	0,7
Budget Deficit (% GDP)	-6,2	-5,5	-4,6	-2,6	-1,8
Public Debt (% GDP)	55,9	60,1	72,6	64,2	62,6
Exports (€ billion)	5	4,9	4,5	6,3	7,2
Imports (€ billion)	5,5	4,8	4,8	6,7	7,5
Unemployment (%)	6,7	7,5	7,4	7,1	6,4

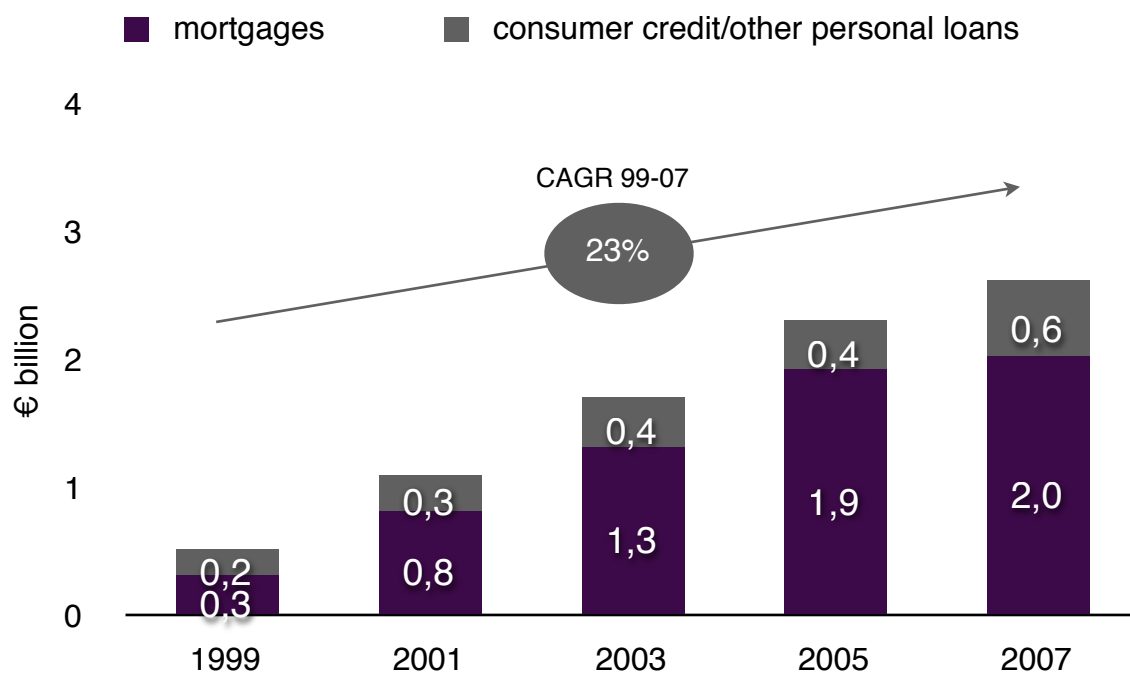
Source: Eurostat, IMF

Exhibit 3: Resident loans in the Maltese banking sector



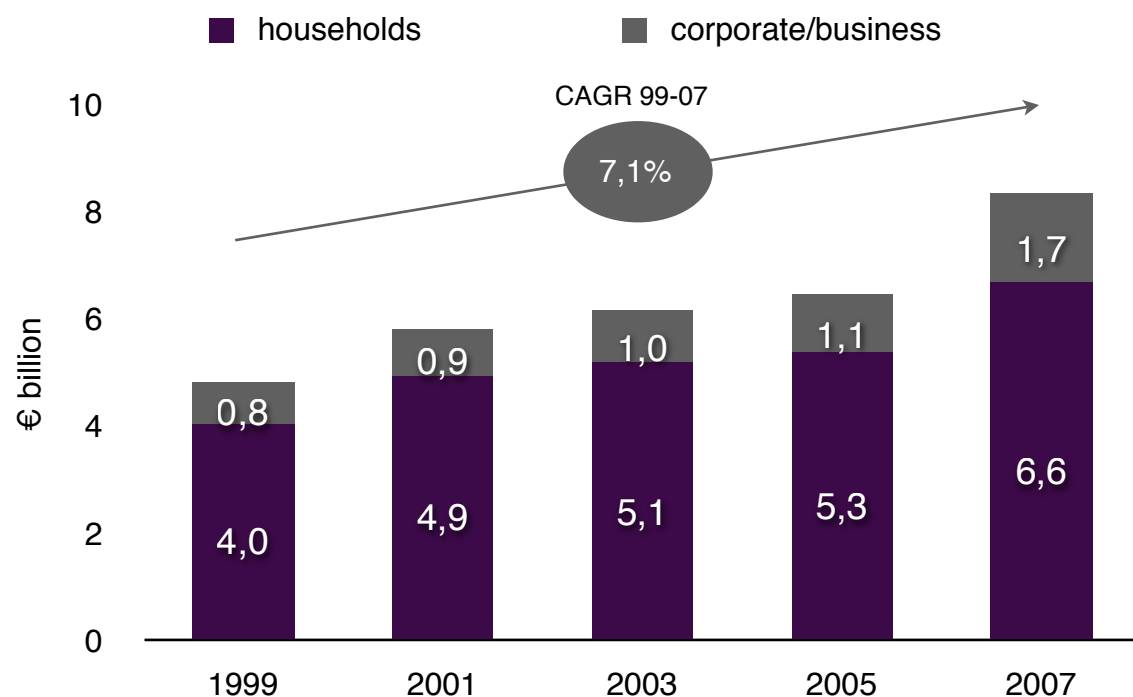
Source: Central Bank of Malta

Exhibit 4: Resident personal loans in the Maltese banking sector



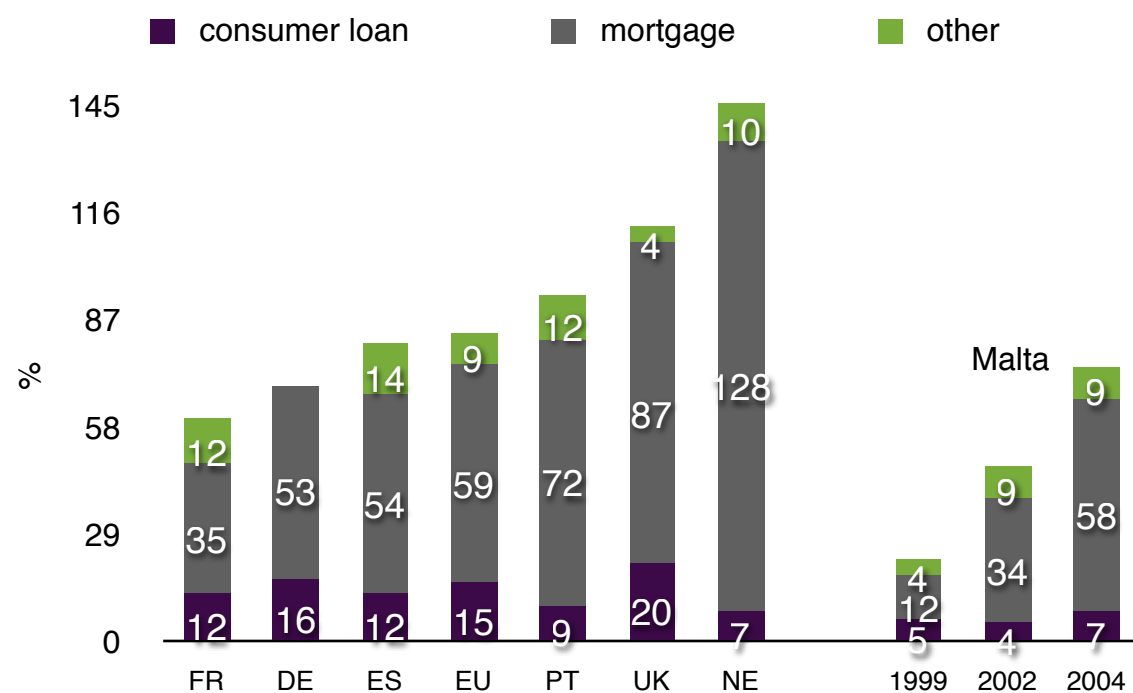
Source: Central Bank of Malta

Exhibit 5: Resident deposits in the Maltese banking sector



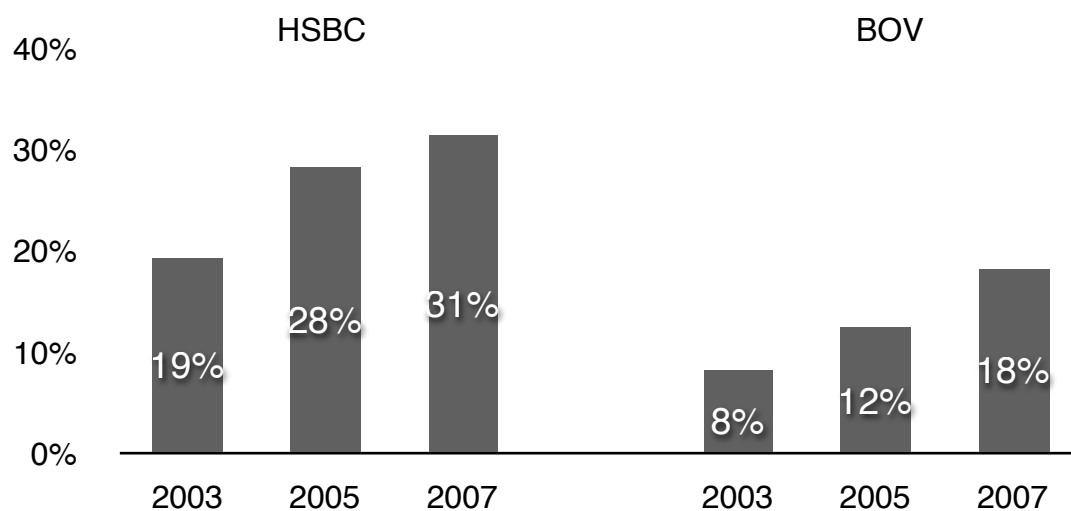
Source: Central Bank of Malta

Exhibit 6: Ratio of outstanding household loans to household disposable income (2002)



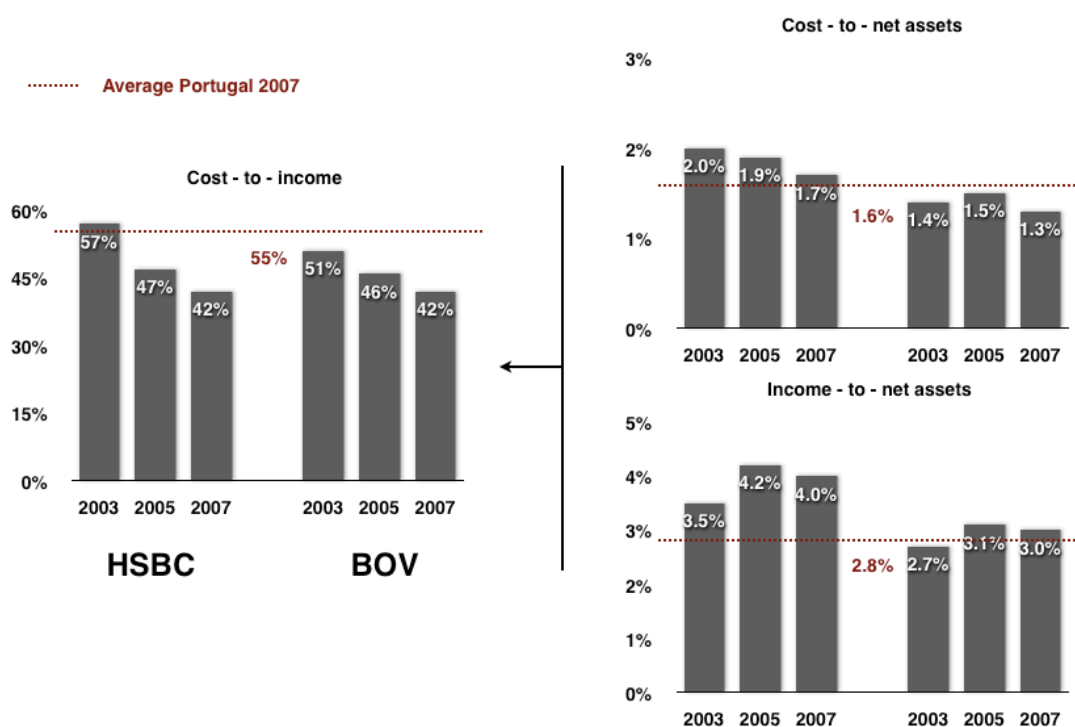
Source: Central Bank of Malta; Economic Cycle Research Institute

Exhibit 7: Return on Equity (ROE) for the two main banks



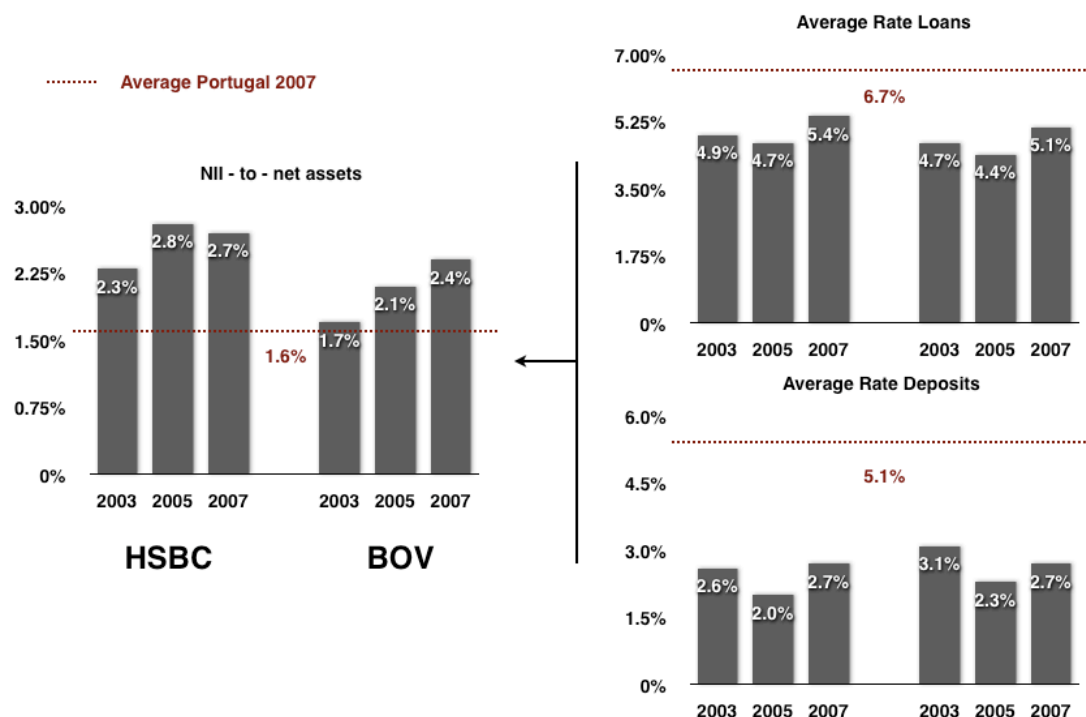
Source: Bank Annual Reports

Exhibit 8: Cost-to-income tree of HSBC, BOV and Portuguese sector average



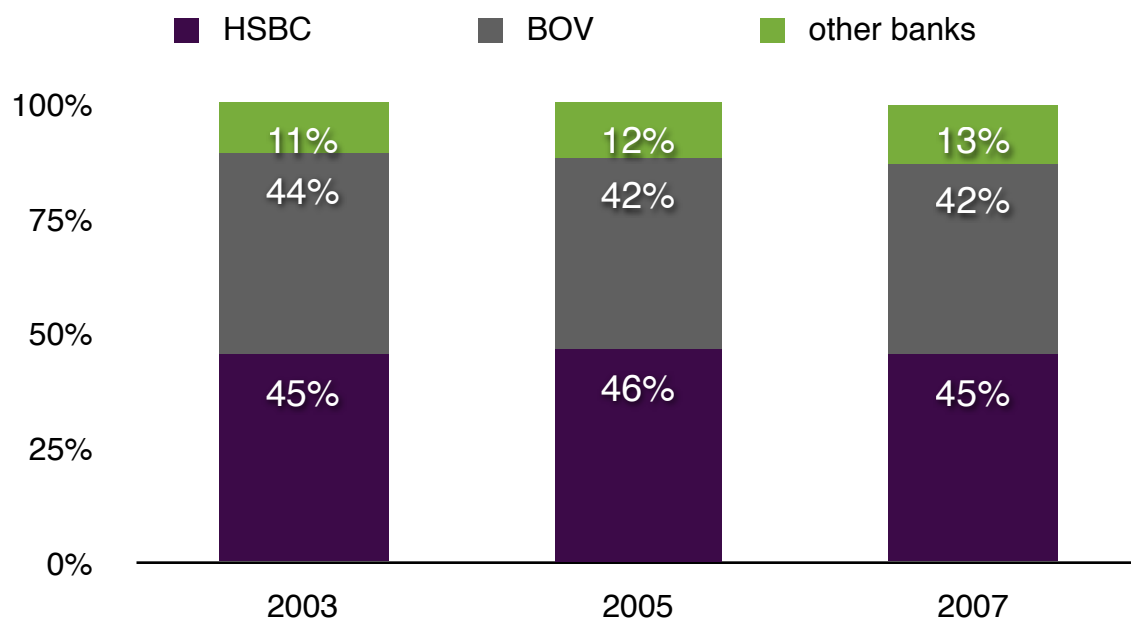
Source: Bank Annual Reports; Associação Portuguesa de Bancos (APB)

Exhibit 9: Intermediation margin tree of HSBC, BOV, and Portuguese sector average



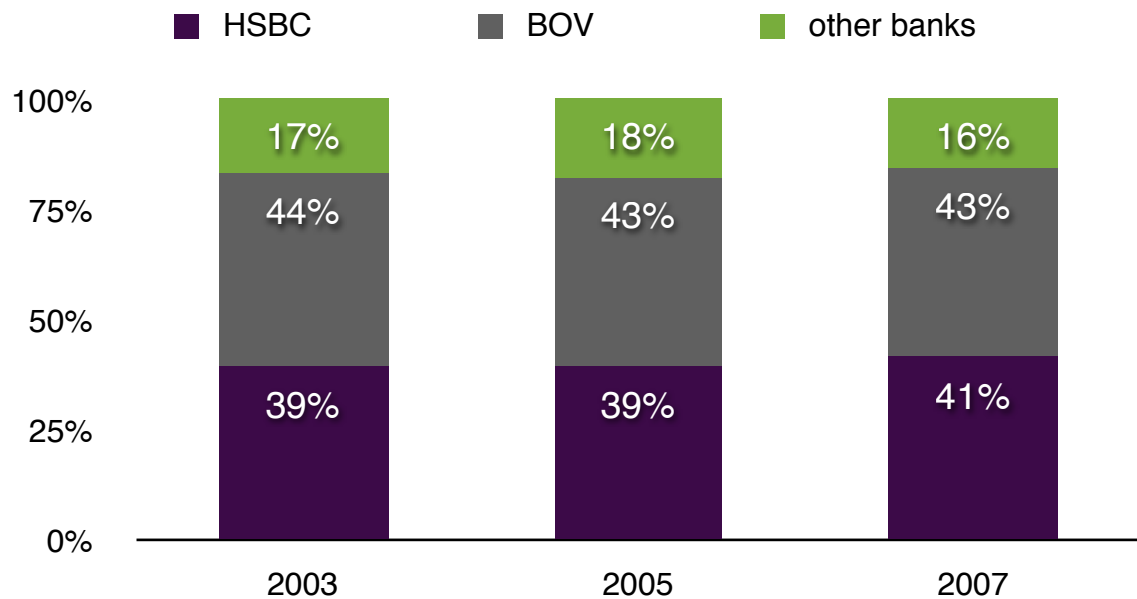
Source: Bank Annual Reports; Associação Portuguesa de Bancos (APB)

Exhibit 10: Loans market shares in the Maltese banking sector



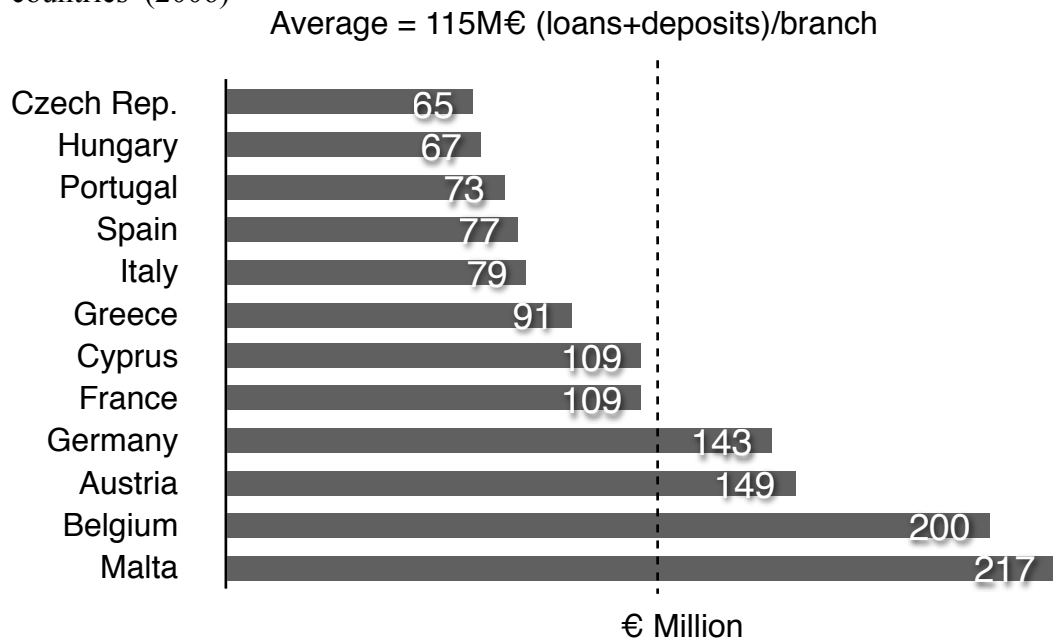
Source: Bank Annual Reports; Central Bank of Malta

Exhibit 11: Total customers deposit market shares in the Maltese banking sector



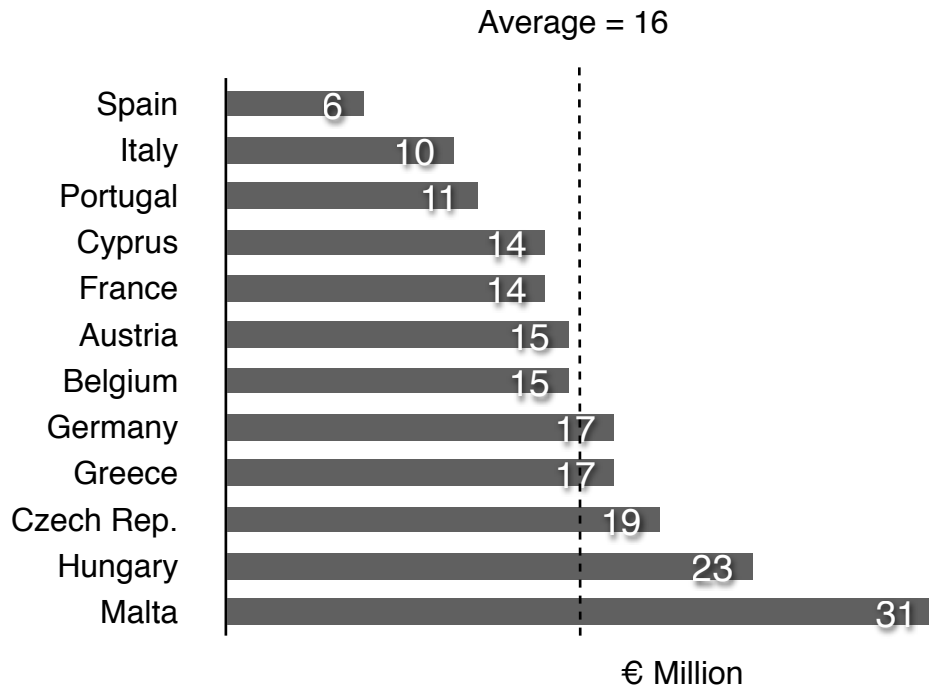
Source: Bank Annual Reports; Central Bank of Malta

Exhibit 12: Comparison of Banking Business per branch across a set of European countries (2006)



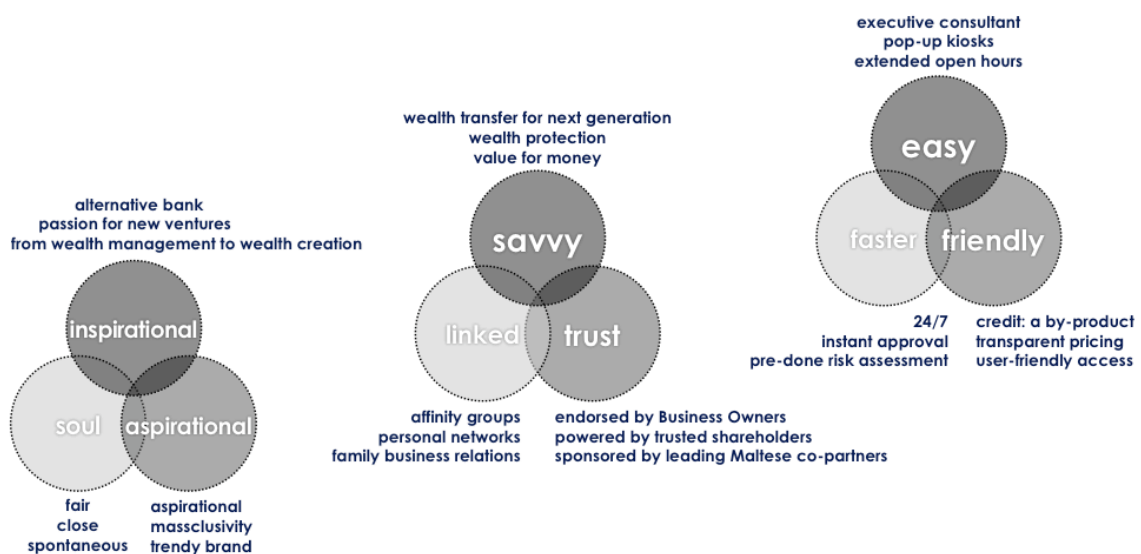
Source: European Banking Federation

Exhibit 13: Comparison of Personnel (FTE) per branch across a set of European countries (2006)



Source: European Banking Federation

Exhibit 14: Cornerstones of the value proposition



Source: soarspartners consulting

Exhibit 15: Example of Medical professional loans

	home loan	personal loan	post-graduate	medical equipment
use of funds	purchasing, construction, completion furnishing	finances wide range of products	post graduate studies	medical equipment
capital	Over €135.000	maximum €35.000 (other amounts would be considered)	€30,000	€50,000
interest rate	reduction of 17,5 bps on the standard interest rate	reduction of 185 bps on the standard interest rate	reduction of 185 bps on the standard interest rate	reduction of 185 bps on the standard interest rate
collateral	purchased property	unsecured	Bank may ask for security	Bank may ask for security
LTV	90% of property value	up to 100%	up to 100%	up to 80% of invoice purchase price
repayment	up to 75 years of age	7 years	7 years	7 years
moratorium	none	none	1 year on repayment of interest	none
payment options	principal + interest monthly	principal + interest monthly	principal + interest monthly	principal + interest monthly
fees	discounted bank processing fees	none	none	none
special conditions	bring your existing home loan to Banif & get up to €500 grant	no processing fees	no processing fees	no processing fees
direct credit on income	applicable	applicable	applicable	applicable
refinancing property loans	> €135,000 BBR reduction 17.5 bps on standard interest rate	none	none	none

Source: soarspartners consulting

Part II: Teaching note

According to Besanko *et al.* (2007), “a firm’s economic profitability within a particular market depends on the economic attractiveness or unattractiveness of the market in which it competes (as summarized by a five-forces analysis) and on its competitive position in that market (i.e., whether it has a competitive advantage or disadvantage)”.

Hence, the subsequent analysis will be divided in three main sections: firstly the market attractiveness will be assessed, by performing an industry analysis in order to explore the economic factors that affect industry profits (**Question 1**). Secondly the strategic positioning of Banif Bank will be described to provide a better understanding about the way the institution proposes to address and compete in the market (**Question 2**). Finally it will be determined if this positioning can create a sustainable competitive advantage, permitting Banif Bank to create superior value in the Maltese banking market (**Question 3**).

Question 1: Is the Maltese banking market attractive?

“The essence of formulating competitive strategy is relating a company to its environment”, as Michael Porter states in its pathbreaking book *Competitive Strategy*. This sentence shows the great importance that a thorough knowledge of the industry structure is crucial. It will determine the competitive rules of the game and all possible strategies for a firm to choose from, and therefore the profit potential in that specific sector. To systematize the analysis, Porter developed a framework to identify the main

economic forces affecting industry profits, based on five competitive forces that go well beyond the established players - internal rivalry, entry, substitutes and complements, supplier bargaining power, and buyer bargaining power. These will be the pillars used to evaluate the intensity of competition and profitability in the Maltese banking sector, complemented by a review of this framework from Besanko *et al.* (2007).

Internal Rivalry

“Internal rivalry refers to the jockeying for share by firms within a market” (Besanko, 2007), so we must begin by clearly defining the market. The analysis will address all commercial banks offering full banking operations in Malta, considering the whole country since it is a very small territory.

The degree of concentration in an industry usually can give a helpful support to assess the nature of competition. “Market structure refers to the number and distribution of firms in a market” (Besanko *et al.*, 2007). To evaluate the concentration there are two available measures: the N-firm ratio and the Herfindahl Index. The latter needs the knowledge of the market share of all firms acting in a given industry while the first one can be computed with the shares of the largest firms competing in that industry. Since there is no information available for all the Maltese financial institutions, this analysis will be made using the N-firm ratio. The information regarding the number of clients is also inexistent, so the shares in terms of amount both in loans and deposits will be used to calculate the ratio. Therefore, the 2-firm ratio for loans equals 0.87, while in terms of deposits it equals 0.84. From these figures one can conclude that we are in presence of a highly concentrated market, which indicates us that intensity of price competition will

tend to be low. There are few players in the market, with HSBC and BOV controlling almost the entire lending and deposits business. By avoiding price wars, banks are practising higher margins, leading us to think that some form of cooperative pricing is established. In the banking sector prices are quickly adjustable, so the fast response time of rivals avoids a potential increasing market share from a price cutter.

Usually differentiation in banking industry exists at service level, since basic banking product, money, is undifferentiated. In Malta customers believe that HSBC and BOV deliver approximately the same service, however some prefer one to another. According to the market study realized by the consulting company, HSBC is viewed as more modern while BOV is more conservative. This fact contributes to decrease price competition, by introducing preferences in the consumer.

Additionally, the main competitors cost structure is similar, with both BOV and HSBC presenting the same cost-to-income ratio, discouraging price cuttings to throw out less efficient competitors. Furthermore, the continuous sector growth over the last years allows established firms to gain new share instead of stealing share from its competitors. All these conditions keep price competition down, so rivalry amongst competitors tends to be low in the Maltese banking market.

However, there are some factors in this industry that heat up price competition, intensifying internal rivalry. We can observe the presence of *switching costs*, costs that a customer incurs when changing from one supplier or marketplace to another. Klemperer (1987) presents three types: 1) “transaction costs in switching between completely identical brands”, 2) learning costs when the knowledge acquired cannot be transferred to other brands of the same product. Finally, 3) artificial or contractual costs exist just

because the firm has created it, and differs from the other two because of the absence of social costs of brand switching. Transaction costs happen in this industry when for example a customer decides to open a current account in a new bank, having to transfer all direct-debit payment orders for utilities. A similar reasoning can be applied with the credit transfer operations, like payment of salaries. Contractual costs can also be found in several banking products, for instance on loans in the form of fees and commissions charged with the transfer, or in withdrawal before maturity of deposits and other applications. These contractual costs automatically disappear with the maturity of the contract, eliminating these switching costs.

Additionally the Maltese banks have *excess capacity* in the lending business, presenting a credit over deposits ratio around 75%. as well as an oversized workforce. Finally exit barriers tend to be high for the banking sector because of Government restrictions, since commercial banks have strong ties with all economic activities, and therefore the bankruptcy of a financial institution has dangerous economic effects, as we have been assisting in these last few months with several banks being nationalised by Governments to avoid the collapse of the financial system.

Substitutes and Complements

For the basic products of a commercial bank, like current accounts, or mortgages, there are no substitutes available. However, for some specific products we can find some substitutes, like specialized credit institutions that offer consumer credit products, business not developed in Malta yet. To address savings necessities, usually Government offers a few products that can be acquired without banking intermediation,

but it is not significant in the total deposits market. In Malta investment banks are all owned by the commercial banks, and stock and bonds markets are also controlled by the main retail banks. Therefore substitutes for the core banking products and services are inexistent, allowing financial institutions to earn above-normal returns.

Supplier bargaining power

The bargaining power of supplier to negotiate prices in the banking industry is low, which permit financial institutions to have higher profits. The crucial input is money, thus, suppliers are mainly the customers with their deposits, so there is a very large number of providers, leading to a industry that is not concentrated. We can consider European Central Bank or Bank of Malta as suppliers with bargaining power, but the excess liquidity of Maltese banks allows them to raise money from these institutions. A few very large companies that deposit big sums of cash can also have a superior bargaining power when negotiating for interest rates or specific conditions, but it is quite irrelevant as a whole. Other factors explaining the low bargaining power of suppliers are the inexistence of relationship-specific investments between the industry and its suppliers or the absence of risk of forward integration by suppliers.

Buyer bargaining power

Since in the banking industry the suppliers and the buyers from the principal input are the same, this force has several similarities with what is said above. The buyers market is not concentrated, since almost all people living in Malta need banking services, as well as all firms operating in the country. The majority of the customers

purchase in small quantity, not representing a large fraction of the seller's sales revenue. The few very large firms differ from the generality of the clients, having superior negotiating power, since they operate with very large sums that are more relevant for the banks. There are very few substitutes available, already previously explained. Buyers do not pose a credible threat of backward integration, and relationship-specific investments between parts do not exist. The existence of switching costs for the customer also lowers its negotiation power.

All these factors show that buyer's bargaining power is low in the Maltese banking industry. However, there are some reasons that can slightly increase their power. Some prices in the market are negotiated between the customers and the clients on each individual transaction, like loan spreads and other conditions of the contracts. These products, like lending for house purchase, normally represent a significant cost for the customer, so they are prone to shop around for the best price. Finally consumer is quite price-sensitive in relation to banking products.

Threat of Entry

When evaluating the threat of entry in a given industry, we should pay attention to structural barriers of entry that exist. We need to also analyze the strategic barriers, that is, the expected retaliation that incumbents may entail when entry occurs, or to prevent entry.

There are several major sources of structural barriers to entry. *Product differentiation* results from brand identification and customer loyalty regarding the incumbent firms, forcing new firms to invest largely in advertising to surpass existing

loyalty. This differentiation exists in the banking industry, as already explained when analyzing internal rivalry, creating a barrier to entrants. The presence of *switching costs* in banking business has also been explained in internal rivalry assessment, also contributing to the existence of barriers.

The *access to distribution channels* also creates a barrier, since in the retail banking industry case there is no common channels to sell the products, each institution needs to create its own branch network, which requires a considerable investment, yet scalable. The existence of large *capital requirements* contributes to raise barriers for a new bank to start its business. The financial authorities who regulate the market demand a minimum capital to initiate activity. There is also a heavy initial advertising spending to create brand awareness.

Economies of scale exist when the unit cost of production decreases as the absolute volume per period increases. This fact limits smaller competitors' intentions of replicating the cost advantage of biggest competitors. Firms that benefit from economies of scale have made strategic commitments, that is, visible, irreversible and understandable decisions that have long-term impact. So entry can be deterred because the entrant is obliged to enter in a larger scale to match the incumbents' unit cost, risking an aggressive response from existing firms, or it will face a cost disadvantage entering in smaller scale. These economies of scale exist in the Maltese banking business, for instance in marketing expenses.

Finally, another origin of entry barriers is *Government policy*. In a highly regulated market like commercial banking, both Malta Financial Services Authority and Bank of Malta have strict regulations and requirements to control financial institutions.

They have to issue a license in order for a bank to operate in the market, therefore raising barriers by limiting entry in the industry.

Strategic barriers are used by incumbents to prevent entry of a new firm in the market (limit pricing), or to throw them out of the market (predatory pricing). An incumbent using the *limit pricing* strategy will set the price sufficiently low to discourage entrants, who will observe the low price and conclude that post entry price will be low and decide not to enter. A firm using predatory pricing will set the price below short run marginal cost with the expectation of recouping the losses when the rival exits. However these strategies are not rational because the incumbent would have to set the price low in each period to deter entry in the next period, never getting to raise the price again to reap the benefits of entry deterrence. Only large asymmetries in information signalling low cost from incumbents would make these strategies more viable, which is not the case in the Maltese banking market.

In sum, the Maltese banking industry presents high potential for profitability, when analyzing all forces combined. Internal rivalry is not so fierce, permitting firms to present very attractive margins. The absence of real substitutes also contributes to the low internal rivalry, and do not capture retail banks' sales. Both suppliers and buyers' limited bargaining power does not present the force to move down prices or increase quality, keeping price competition low. Finally a quite low threat of entry allows the incumbent firms to enjoy high profitability. The qualitative assessment of industry profitability is reflected in the figures presented in the case. In fact the intermediation rate of the two main Maltese banks is expressive, with HSBC attaining 2.7% and BOV

2.4% for 2007, when compared with Portuguese banks average of 1.6% (Exhibit 9). According to banking business per branch, Malta presents a deficit in branch coverage, thus we can say that there is still space for a new entrant in the market to develop a distribution network.

Question 2: How will Banif Bank position itself in order to create a competitive advantage in the industry?

After assessing the attractiveness of the Maltese banking sector, we then need to analyze Banif Bank value proposition, to understand if it can create a competitive advantage. This happens “when a firm earns a higher rate of economic profit than the average rate of economic profit of other firms competing within the same market” (Besanko *et al* 2007).

According to these authors, a competitive advantage cannot be translated into a formula, because if feasible, it would turn the benefits accessible to everyone, and consequently valueless. However we can distinguish some common lines in the firms’ different positioning across industries. These commonalities have been turned into the concept of generic strategies by Michael Porter (1980), describing broadly the way each firm positions itself to compete in the market. This concept of strategic positioning lies in two dimensions. Firstly a firm needs to define how it will create value: pursuing a cost leadership or a benefit leadership strategy. The second dimension deals with the question of where will the firm position itself to create value: across a broad scope of market segments, or focusing on a specific market segment.

The logic behind cost leadership deals with the firm capacity to produce at a lower cost per unit than its competitors. So, the firm has the possibility of undercutting rivals' prices and sell more than they do, pursuing a share strategy, when there is high price elasticity of demand. The firm can otherwise match rivals' prices and exploit its cost advantage through higher profit margins. This margin strategy is better suited for markets with low price elasticity of demand, since in this case large price cuts gain little share.

Benefit leadership occurs when a firm offers products with a higher perceived benefit than competitors, being able to charge a price premium, and therefore creating more value. This is possible through three different ways: either by offering products with the same cost but higher benefit; products with a slightly superior cost but enhanced benefit; or finally by offering a substantially superior benefit and cost than competitors.

The capacity to exploit a competitive advantage through this strategy also depends on price elasticity of demand, like in cost leadership. In this case, a firm should pursue a share strategy when the elasticity tends to be high. Maintaining price parity with competitors will permit the benefit advantage to drive the increase in market share. When low elasticity exists, the firm should charge a price premium relative to competition, building its advantage through higher profit margin, since large increases in price just slightly erodes market share.

Regarding the second dimension, one can affirm that nearly every market can be divided into smaller pieces. This segmentation is based on a few parameters, like

“customers economics (e.g., differences in willingness-to-pay or differences in willingness to trade off quality for price), supply conditions (e.g., costs of producing different product varieties), and segment size” (Besanko *et al* 2007). The differences in these parameters between industries create the possibility of designing value propositions specifically tailored to create value in a specific market segment.

A firm pursuing a broad coverage strategy seeks, for instance, to create a competitive advantage either by serving all the market with a full-range of related products, or by offering the same product to all customer groups. The economic logic behind these options arises from the benefit of economies of scope across product classes in the first case, either in production, distribution or marketing. In the second case the firm will exploit the economies of scale that one-size-fits all strategy permits, since it will sell the same product to all its clients.

When competing under a focus strategy, a firm can choose to be specialized in one of three different ways: customer, product, or geography. Note that a firm can use a combination of these three dimensions to pursue a focus strategy. If the firm chooses to offer a wide range of products to a specific customer group, it is trying to create more value by attending to the specific needs of these customers who are usually underserved or overserved by broad coverage competitors. These competitors usually either offer insufficient levels of product attributes this customer segment especially values, or costly features that are not particularly valuable to these clients.

A firm can also pursue a product specialization strategy, choosing to offer a limited type of products to various customer groups. The goal is to attend a specific

subset of the customer needs in a more efficient way, and therefore benefiting from economies of scale or learning within the product the firm is specialized in.

Finally a firm can offer a wide range of products in a narrowly defined market, being able to exploit economies of scale that would be more difficult to achieve if it expanded to a broader market, or exploit specific market conditions in that region that broad-coverage competitors cannot attain.

Banif Bank opted to pursue a benefit leadership strategy, focusing on a specific segment of the Maltese population. The results presented in the market study showed that the Affluent and SME segments were being underserved by the broad-coverage competitors like BOV and HSBC, who were offering them off-the-shelf products, with few attention to their necessities. Banif objective is to present them a full-range banking service that is designed to fulfil their needs of a more sophisticated approach and special treatment. Since the Maltese consumers stated in the market study that price was not a major decision argument, comparing to service level and proximity who were more valued, the bank should explore the advantage through higher profit margins.

The financial institution is proposing a new distribution channel design, based on a mobile sales force: the Executive Consultants. A thorough analysis of the client's sector is made prior to the approach, permitting to better understand what are their particular needs. The Consultant is empowered by the bank to make fast decisions, crafting together with the client solutions to every need. This mobile network is supported by a powerful back-office who permits fast decision making, and appealing branches. The products must remain simple, transparent and easy to understand, because nowadays customers are getting tired of having to learn how to consume. To

complement the selling strategy Banif aims to create a strong and aspirational brand, in line with the segment it is addressing to. A marketing approach based on more public relations and the creation of a community, instead of heavy advertising spending, will be used to enhance Banif image and build the aspirational brand.

The bank is then proposing to offer a service with a higher perceived benefit to a specific segment of the Maltese population, being able to create more value. Still, the institution aims to be at the same time extremely cost efficient, in order to also extract superior value from a cost leadership strategy. Banif is a new bank with light and flexible distribution channels, and centralized back-office, which permits to operate with a smaller work force. A fierce incentive for new technologies usage also allows to keep costs low.

The value created by a firm equals the difference between the perceived benefit (B) of a given product and its cost (C). Banif is aiming to create superior economic value by increasing B, and simultaneously decreasing C. By maintaining a similar price (P), the bank is offering a superior consumer surplus (B-P), while extracting more producer surplus (P-C), and therefore increasing its profitability.

According to Michael Porter (1980), a firm that tries to pursue both strategies at the same time will fail to construct a competitive advantage since the strategy will lack clarity and coherence, leading to less profits. This is what the author called being “stuck in the middle”, because a competitive positioning requires the existence of trade-offs between cost and benefit. However, as Besanko et al (2007) points out, the quest for both advantages can be compatible in certain circumstances. For instance, inefficiencies can alter the perception that high quality corresponds to high costs. The

fact that both BOV and HSBC are installed in the market for a long time without strong competition did not create the incentives for a real increase in the efficiency of these institutions, who continue to operate with large branches and staff, or decentralized back-office operations, for example. Moreover, when offering high quality services, Banif can increase its market share in that segment, which can lead to economies of scale and learning, reducing average costs. Therefore, the bank can achieve both a benefit and a cost leadership in the industry.

Question 3: Will the competitive advantage be sustainable in the long term?

The right strategic positioning is crucial for the bank's ambition to achieve competitive advantage in the Maltese banking market. However this is not enough to guarantee above-normal returns in the long term. The sustainability of the advantage is an essential condition to fulfil that ambition.

Following closely Cool *et al.* (2003), a sustainable competitive advantage can arise from two main sources. The "resource-based" view of strategy defends that firm specific resources are crucial to achieve a competitive advantage. But this superior performance can also arise from privileged market positions.

Strategic Resources

We will start by addressing the resource-based view of strategy. Several authors defend that firm-specific resources are the source of sustainable above-normal returns, because if firms possess the same resource bundle, they could all replicate the same

strategies. Thus, *uniqueness* is a necessary condition for creating a competitive advantage. Therefore, some main aspects that need to characterise resources in order to sustain a competitive advantage will be discussed as following.

First, resources have to be obtained in *imperfectly competitive factor markets*. Barney (1986) points out that a “strategic factor market” is a “market where the resources necessary to implement a strategy are acquired”. A distinction between *tradeable* and *non-tradeable* has to be made in order to explain this aspect. *Tradeable* resources can be obtained in factor markets, like a new technology or a new factory for instance. In this case, it is obvious that an imperfectly competitive factor market, that is, “different expectations about the future value of the resource” (Barney 1986) need to exist, in order to achieve above-normal performance. Otherwise, the cost of the resource would match the value created with the use of the resource to implement a given strategy. *Non-tradeable* resources cannot be traded in factor markets, due to their incompleteness, like reputation or brand loyalty. These are resources that result from a complex and time-consuming accumulation process, avoiding acquisition by competitors. The imperfect market factor argument can be applied to this kind of resources, extending “competition in factor markets to competition in resource accumulation” (Dierickx and Cool, 1989). Since it is a process of accumulation over time, the resource value is hard to be perceived at the moment of acquisition, the market is then imperfect, permitting higher profits.

Even though *uniqueness* and *imperfectly competitive factor markets* are conditions for resources to generate higher profits and competitive advantage, they are not sufficient to support them over time. A sustainable competitive advantage must also

be a result of *imperfectly mobile resources*, which can be traded in the market but are more valuable for the firm who has developed them than in another firm. This difference can result from specific relationships, or cospecialization of assets - that is, more valuable when used together than separated, for instance. Being less valuable to the competitors, imperfectly mobile resources will not be bought, staying linked to the firm, resulting in above-normal results.

However, competitors can try to imitate the resources that are imperfectly mobile or result from imperfect factor markets, by accumulating similar asset stocks. Therefore firms have to guarantee the *nonimitability* through *isolating mechanisms*. These mechanisms are divided in two types: *economies of resource accumulation* and *barriers to imitation*.

The first dimension results from a process of resource accumulation that, once the competitive advantage is created, continuously enhance this advantage relative to competitors. This process arises both from *asset mass efficiencies* and *interconnectedness of asset stocks*. Asset mass efficiencies result from the fact that being the first to develop a certain resource will permit to have lower costs when continuing to accumulate asset stock. This can arise from economies of learning, that is, when accumulating production quantity over time, the unit cost will decrease. Interconnectedness of asset stocks deals with the fact that the process of accumulation of one resource will also be affected by the accumulation effect of complementary assets.

The second dimension, *barriers to imitation*, prevents that any other firm replicates the specific resource by simply not allowing it to be copied. These barriers

can be of three different types: *time compression diseconomies*, *causal ambiguity*, and *exclusivity*. The first type deals with the fact that a firm obtains a higher resource level when maintaining a certain level of investment over a period, than a new firm arriving later to the market who tries to regain lost time by investing the double in half the period. This effect can be observed in marketing expenses to create brand awareness, for instance. *Causal ambiguity* arises from the problems competitors face when trying to understand the exact sources of accumulation. They are unable to pinpoint the specific factors that contribute to that asset stock. This results from tacitness, complexity and specificity, three characteristics of resources (Reed and DeFillippi 1990). *Exclusivity* arises from restricted access to resources, like patents, trademarks or specific licenses.

Finally, the resources have to be *nonsubstitutable* in order to be sustainable. This factor is necessary because, even if competitors cannot imitate a given resource, they can try to create a similar, or even a completely different one that allows them to implement the same strategy. This is what Barney (1991) calls “*strategically equivalent resources*”.

To assess the potential creation of a sustainable competitive advantage by Banif Bank, we need to analyze three distinctive competences that will permit the bank to translate into reality the desired positioning: easy, trustful and aspirational. We have to keep in mind that since the bank is being established at the present, these are competences yet to be built according to the strategy proposed. In this sense, the analysis will rest upon Banif capabilities on mobile distribution channels, marketing, and back-office operations.

Starting by addressing the competence in distribution channels, one should refer these as a major support to obtain a superior penetration within Affluents and SME's segments, overcoming some installed convenience and conservativeness of the Maltese population. In fact, the main competitors remain attached to the traditional form of doing banking, merely waiting the customer to look for their undifferentiated products in the usual place: the old looking branches. Banif is proposing to transport the bank closer to the target segments, to better serve their needs.

To assist the mobile sales force and provide rapid and tailor-made solutions, the bank will develop new skills in back-office operations to maximize process simplicity, and to provide a fast response, having pre-done risk assessment.

Finally a new marketing approach creates the superior image through sharp advertising, and target chosen segments with specific product packages. As stated in the case-study, a careful prior analysis of every sector through profound research, focus groups, and professional chambers collaboration, permits to direct marketing efforts to what the target clients really need.

Thus, we can say that Banif resource-based positioning relies on distinct capabilities that will permit to efficiently implement its strategy, entering in underserved segments. Relating to the literature, these resources, being organizational capabilities, can be listed as nontradeable since they are time-consuming processes of accumulation, developed inside the firm. Therefore they cannot be acquired in factor markets, creating a competitive advantage.

Even if competitors will not be able to obtain these competences by acquiring them, we should verify if they cannot be imitated by competitors. Concerning the

isolating mechanisms of Banif capabilities, we must begin by analyze the interconnectedness of the bank's assets. If rival firms desire to replicate Banif position, they would have to construct the entire set of activities. Banif is creating an unique one, with a mobile sales force that takes the bank to the clients. The Executive Consultant visits them wherever they prefer, and has a deep knowledge about their professional and private needs concerning banking products that permits to present tailor-made solutions, with fast response since back-office operations are designed to pre-assess credit scoring. Moreover, the technologic network with enhanced ATM's and a powerful internet banking site reinforce the easiness to perform several operations, without having to go a branch. All the co-promoted events, besides the "look&feel" branches contribute to create an aspirational brand, that transmit the status of Banif customers. In fact, these competencies reinforce one another, and need to be built at the same time in order to deliver the desired results.

Banif will also benefit from asset mass efficiencies, since it will be the first bank to specifically address the Affluent segment with a new mobile distribution channel, and tailor-made product packages to better serve those clients. Being the first to develop these resources, they will move farther down the learning curve and achieve lower unit costs than rivals.

The barriers to imitation arise from causal ambiguity, since competitors will face difficulties in detecting what are the activities that will contribute to the accumulation. The ambiguity will result from tacitness, since Banif will learn by doing before the competitors try to copy them. Complexity resulting from the interdependence of both specific product packages and Executive Consultants service, combined with fast

response from back-office, will also enhance the ambiguity when trying to detect the source of the competitive advantage.

Even though competitors will have difficulties to imitate Banif's resources, they could employ their own assets to reach a similar position and address the Affluent segment. By using the large customer base information and branch network, the competitors could be able to attend those clients' needs in a different way.

Privileged Market Positions

Privileged market positions allow firms to obtain higher profits by diminishing the incentives of competitors to replicate that positioning. Several sources contributing to this fact have been identified by economists. First, *economies of scale and scope* limit smaller competitors' intentions of replicating the cost advantage of biggest competitors. Firms that benefit from economies of scale have made strategic commitments, that is, visible, irreversible and understandable decisions that have long-term impact. These sunk costs alter its competitive incentives, thus impacting on intensity of competition, leading to a less aggressive behaviour from competitors. Therefore, the firm that made the commitment will benefit by achieving superior profits.

Another potential source for privileged market position may be the existence of *switching costs*, costs that a customer incurs when changing from one supplier or marketplace to another, as already explained in the internal rivalry assessment.

Network externalities are also source of competitive advantage. They exist when the consumer is better-off when other consumers also use the same product, the more

the better. Installed firms with a larger client base have a strategic advantage, limiting smaller players intentions to grow.

Finally, a privileged market position may arise from *product variety*, *brand* or *geographic proliferation*. This happens when a dominant firm choose to “flood” the market with several products differing according to the above said dimensions, with the objective of gaining market share, limiting the space available for competitors to grow. But this investment has to be irreversible to be permit a competitive advantage. The dominant firm cannot be able to withdraw its products without incurring in big losses.

In the Maltese banking market, the two main players have a competitive advantage that arises from privileged market positions. Controlling almost half of the market each, HSBC and BOV benefit from economies of scale, that arise from a larger customer base. They have also already incurred in several investments that can be considered sunk costs, such as branch deployment or heavy advertising expenditures for the creation of the brand. Switching costs also exist in banking industry, as already explained in industry analysis, benefiting the large incumbents. Finally, geographic proliferation also contributes for the existence of privileged market positions for the two main players, because their branches cover the entire country.

Banif Bank can try to mitigate these privileged market positions, benefiting from the dimension of Banif Financial Group, exploring all synergies available. However, one of the competitors, HSBC Malta, belongs to one of the largest world banks, which limits this corporate advantage.

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